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FEAR OF ADJUSTING: THE SOCIAL COSTS OF ECONOMIC POLICIES IN COSTA RICA IN THE 1970s

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FEAR OF ADJUSTING: THE SOCIAL COSTS OF ECONOMIC POLICIES IN COSTA RICA IN THE 1970s.

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Like most small and open economies, Costa Rica has always been vulnerable to the influence of external forces. After 1973, however, the country experienced several external shocks that caused much greater disturbance than any suffered during the previous two decades. Since this sequence of sizable shocks took place in a relatively short period of time, it substantially increased the instability of the economy and magnified its adjustment problems. Although the various disturbances differed among themselves in nature, their effects reinforced each other, while rigidities in the economic and political system made adjustment difficult. This chapter examines the nature of these shocks, the problems that they posed, and the ways in which the country dealt with them.

In 1982 Costa Rica found itself in the midst of an acute crisis, characterized by a stagnant economy, growing unemployment, rampant inflation, and a rapid devaluation of its currency. In addition, the country had accumulated a huge foreign debt that it found very difficult to service. Paradoxically, Costa Rica had shown remarkable progress during the previous three decades, in terms of both economic growth and social welfare improvements. Given the country's resource base, particularly its homogeneous and well-educated population, as well as its political stability, a longstanding democratic tradition, a large middle class, and a less uneven distribution of income than most other Latin American countries, many find it difficult to understand the speed with which the economic situation deteriorated and the extent of the damage to the country's economic and political structures. As a recent report claimed, "no one would have predicted the present outcome even as recently as five years ago, when the country was enjoying an extraordinary coffee bonanza."[1] Although the seeds of the crisis had been sown a long time before, one cannot help but be impressed by the degree of change the country has experienced and the speed with which this change has occurred.

This chapter provides a systematic description of the difficult problems of adjustment faced by a small open economy. Although political influences on the evolution of events have been taken into account, no attempt has been made to explain them. The analysis herein suffers from all the biases implicit in an economic approach; moreover, it does not strive for the formal elegance of economic models. The chain of events that took place could have been easily predicted from the perspective of economic theory, but the fact that the Costa Rican political system did not react with the speed, energy, and innovation required to avoid a major crisis suggests that democratic countries may face serious political constraints in adjusting to sharp external shocks. Moreover, I argue that serious mistakes of economic policy management resulted from political attempts to avoid or postpone an appropriate adjustment, and that these errors further complicated the problem and significantly increased the social costs of adjusting. Short-term political gains were thus obtained at a very high price. In turn, the economic crisis that resulted could eventually undermine the country's political system.

THE NATURE OF THE SHOCKS

Economic crisis in Costa Rica has been the consequence of a combination of long-term structural trends, whose unfavorable effects accumulated slowly but steadily, and of particularly unfortunate short-term circumstances, both at home and abroad. These short-term circumstances included dramatic external shocks, followed by slow and faulty policy decisions in response to these shocks.

The major external shocks were (1) the two international oil crises, in 1973-74 and 1978-80; (2) sharp increases and subsequent declines in the international prices of several agricultural commodities, associated with the coffee boom of 1976-77; and (3) changes in the country's access to international capital markets. Easy access to borrowing abroad was made possible in the mid-1970s by the international recycling of oil profits and the country's creditworthiness during the coffee boom. However, high interest rates that eventually resulted from world inflation greatly increased the burden of servicing this debt, at a time when the large capital inflows of the earlier years were abruptly interrupted because of the crisis.

War, insurrection, and political instability in Central America reinforced the unfavorable structural trends implicit in the protectionist strategy of import substitution (as subsequently discussed) and added further sources of external disturbance. Political events in Central America, however, have not been the major cause of the economic crisis in Costa Rica. This crisis would have occurred even in the absence of turmoil in the rest of the isthmus. Although this turmoil has not yet reached Costa Rica, the deterioration of the Central American political situation and the uncertainty about the economic and social policies of regimes in the area have reduced the viability of the Central American Common Market and its attractiveness for Costa Rican exporters. Morover, by reducing confidence and accentuating pessimistic expectations, political developments have contributed to the contraction of domestic investment and to substantial capital outflows. Events in Central America, therefore, have accentuated the crisis and have added further constraints to the adjustment.

STRUCTURAL BACKGROUND

The nature, extent, and duration of the crisis are in part explained by the structural features of the Costa Rican economy. These elements reflect contradictions between some of the country's most basic characteristics and some of the features of the protectionist strategy of import substitution adopted in the late 1950s. Since this strategy has been pursued for almost three decades, its consequences have been incorporated into the country's productive structure. The contradictions reflect a neglect of crucial economic variables, like market size and factor endowments.

Two main characteristics of the Costa Rican economy have been its small size, with the limitations imposed by a poor domestic market, and its high degree of openness to foreign trade, a consequence of small size. With a population of 2.3 million inhabitants and a gross domestic product (GDP) of about 100 billion *colones* in 1982, Costa Rica is a very small economy.[2] Given a specialized resource base and a small domestic market, traditionally the country has understood that foreign trade must serve as the economy's engine of growth. Thus, much of the impulse for growth during this century has been provided by the export of agricultural commodities. Exports of coffee, bananas, sugar, and beef have raised the levels of domestic output and income, increased the country's import capacity, and yielded many of the dynamic benefits of specialization.

Costa Rica is one of the most open economies in the world. During the past three decades, exports have represented between one-fifth and two-fifths of the GDP and this proportion has increased over time.[3] Imports have represented between one-quarter and one-half of the GDP, with a similar increasing trend. About two-thirds of the country's agricultural output has been exported, whereas agricultural exports have earned about two-thirds of its foreign exchange. Trade has also played an important role in the development of the manufacturing sector. When Costa Rica joined the Central American Common Market in 1963, exports of manufactured goods represented only 4 percent of total exports, but this grew to 29 percent by 1979. About four-fifths of these exports, however, have gone to markets in Central America protected by the regional integration effort, rather than into competitive world markets.

With its participation in the Central American Common Market, Costa Rica consolidated its choice of a protectionist strategy of industrialization via import substitution. This decision modified the nature of the economy's external dependence. At the regional level the strategy involved free trade among the Common Market partners and the establishment of a common, highly protective, external tariff barrier for imports from all other countries. Costa Rica chose to increase the degree of openness with respect to Central America, while at the same time reducing openness with respect to the rest of the world.

Industrialization via import substitution was adopted in order to reduce dependence on international markets and to avoid the fluctuations and uncertainties associated with a concentration on exports of primary products. It was believed that the regional market offered a greater growth potential and was safer and more predictable than the international market. Recent political events in the isthmus show that this regional market is no longer secure. Furthermore, it has never been a large market. Market size is crucial for successful industrialization, because it determines the scope for the exploitation of economies of scale and the extent of competition, as well as the degree of viable specialization. Market size also influences the extent to which inward-oriented industrial development may proceed without incurring excessive costs. Unfortunately, regional integration in Central America led to the establishment of many high cost industries and to limited competitiveness in international markets.

GRADUAL STAGNATION

The Costa Rican economy grew at a very satisfactory pace during the past two decades. Between 1960 and 1980, the GDP, measured in 1966 prices, grew at an average rate of 5.8 percent per annum. However, although the average annual rate of GDP growth was 7.0 percent for 1965-70 and 6.0 percent for 1970-75, it was only 5.2 percent for 1975-80. This long-run decline in growth rates has been accentuated by the recent crisis. From a historical high of 8.9 percent per annum in 1977, a consequence of the coffee boom, this rate of growth rapidly dropped and finally became negative in 1981 and 1982 (-2.3 and -9.1 percent, respectively).

The decline in growth rates has been shared by all major sectors. The average annual rate of GDP growth in the agricultural sector, measured in 1966 prices, dropped from 8.1 percent for 1965-70 and 3.4 percent for 1970-75 to only 1.8 percent for 1975-80, despite the coffee boom. This deceleration reflected, in part, the penalization of agriculture and exports that resulted from the import-substitution strategy of industrialization. The industrial sector has also stagnated. The average annual rate of GDP growth in manufacturing, measured in 1966 prices, dropped from 9.3 percent for 1965-70 and 8.9 percent for 1970-75 to 6.0 percent for 1975-80. Recently, this rate of growth steadily declined from 12.7 percent in 1977 to a negative -0.5 percent in 1981 and -14.9 in 1982.

The relatively high rates of growth in the manufacturing sector during the 1960s and early 1970s resulted from the dramatic increase in Central American trade after the formation of the customs union in 1963. During this first stage of import substitution, domestic production rose more rapidly than domestic consumption, as it not only provided for increases in consumption but also replaced previous imports, which had represented the main source of supply of manufactures. Eventually, this "easy" stage of import substitution was exhausted and the growth rate of manufacturing output declined to the level of the growth rate of domestic consumption, which in turn continued to be determined mostly by the country's exports to international markets. Indeed, an external shock, the coffee boom, explained why this long-term trend toward stagnation was temporarily stopped in the mid-1970s. Otherwise, the strategy's negative impact on growth would have become evident earlier.

PROTECTIONISM AND RIGIDITY

The setting up of manufacturing industries to serve a small regional market was based on high protection. Although very high levels of effective protection were adopted for most consumer goods, low and even negative rates of effective protection were granted for the production of raw materials, intermediate inputs, and capital goods.[4] Moreover, the effective rates of protection have been characterized by a great dispersion. Almost half have fallen below 50 percent, whereas for about one-fifth of the items these rates have been above 200 percent. Although the average legal rate of effective protection has been about 164 percent, it has been about 231 percent for traditional consumer goods and only 77 percent for intermediate goods and 62 percent for metal-mechanic industries. Moreover, protection was accentuated by favorable fiscal treatment, tax concessions, and other incentives for investment in the industrial sector, as well as by credit and foreign exchange policies that implicitly subsidized these activities. When all the determinants of effective protection are taken into account, "Costa Rica has been the most highly protected country in the region."[5]

One of the consequences of this structure of protection has been a very high import intensity in the manufacturing sector. It has been estimated that in order to produce $100 worth of output, the manufacturing sector needs $80 of imported inputs. As a result, the Costa Rican economy has become increasingly dependent on imported raw materials, intermediate inputs, and capital goods, and this has led to increasing rigidity in the economy. That is, not only has the Costa Rican economy progressively lost its dynamism, but it has also become less capable of adjusting to the inevitable external shocks. One of the main reasons for this increased rigidity has been the high import intensity of its manufacturing sector. This has been reflected in the composition of imports, of which less than 20 percent represent consumer goods. The balance-of-payments adjustment required after an unfavorable external shock forces a reduction of imports, mostly of raw materials, intermediate inputs, and capital goods destined for industrial firms. Adjustment, therefore, implies a reduction of the level of activity, investment, and growth in the manufacturing sector, and eventually unemployment.

This scenario introduces an important dilemma for Costa Rican policymakers: Sharp balance-of-payments adjustments have a negative impact on growth and employment, particularly in the manufacturing sector. This impact takes place at a time when export earnings, due to the external shock, are also contracting. On the other hand, lack of balance-of-payments adjustment, which would otherwise be attained through increased foreign borrowings and the introduction of domestic controls, worsens the economy's long-term problems and increases the social costs of the final adjustment.

As the Costa Rican manufacturing sector is politically strong, delay of the adjustment has also been associated with attempts to divert the costs of adjusting to other sectors through increased intervention in the economy. The government, in turn, has been willing to respond to these demands that the adjustment be postponed, because it has preferred to adopt a short-run perspective, particularly when elections are near. All of this has introduced greater rigidity in the choice of economic policies, has led to a postponement of the adjustment, and has greatly increased the social costs of the crisis.

The nonuniform tariff structure associated with the protectionist strategy of industrialization has also reflected the permissive attitude associated with granting protection. Incentives have been provided to all politically strong investors, including multinational corporations, and the magnitude of the assistance has mostly reflected the relative strength of the participants in the political arena. Much entrepreneurial time and effort has been spent in lobbying rather than in increasing productivity. As a consequence, specific activities have been promoted without concern for comparative advantages within the manufacturing sector.

The distortions and inefficiencies brought about by this permissive attitude are apparent in the structure of production, impose high costs on domestic consumers and increase the rigidity of the economy. A clear example of inefficiency has been the protection of about a dozen car-assembling plants, all attempting to supply the miniscule Costa Rican market and generating negative net domestic value added. Furthermore, neglect of efficiency and of comparative advantages has resulted in a limited capacity on the part of the manufacturing sector to compete outside the protected Central American Common Market. When the Common Market finally broke down, exports of manufactures could not be diverted to other markets, a factor that also contributed to the stagnation of the Costa Rican economy.

FACTOR PRICES AND EMPLOYMENT

Another key feature of Costa Rica is its relative abundance of labor. The protectionist strategy distorted not only relative commodity prices, turning the domestic terms-of-trade against agriculture; it also distorted relative factor prices, thereby underpricing capital and overpricing labor in the modern sector of the economy. Minimum wages and substantial payroll taxes, used to finance several public sector programs, resulted in an effective cost of labor for employers considerably higher than the wages actually received by workers. Social security and other charges mandated by the government imposed a surcharge of at least 26 percent on all wages and salaries. Modern sector wages became higher than the social opportunity cost of labor for the economy as a whole.

At the same time, several policies underpriced capital for the modern sector. These policies included the tax treatment of investments, which granted tax breaks on physical capital formation but not on human capital or technological development; the fixed, overvalued foreign exchange rate, which set the cost of imported capital below its social opportunity cost; tariff exemption for capital imports, which increased the rate of effective protection of capital-intensive activities; and the credit-rationing policies that resulted from under-equilibrium interest rates in formal financial markets, which have favored relatively capital-intensive activities.

While trade policies have favored manufacturing, the most capital-intensive sector of the economy, factor-price policies have favored capital-intensive techniques in the rapidly growing modern sectors. The result has been limited labor absorption by the private modern sector, where productivity and wages have been higher than those in the traditional sectors. This has forced the public sector to become an active employer in order to avoid higher unemployment. The limited job-generating capacity of the manufacturing sector has been reflected in the fact that during the first decade after Costa Rica joined the Common Market, between the census years of 1963 and 1973, the relative contribution of manufacturing to the GDP increased from 14.3 to 19.7 percent (for a gain of 5.4 points), whereas the proportion of the labor force employed in the manufacturing sector increased from 11.7 to 12.9 percent (for a gain of only 1.2 points). During the second half of the 1970s, the proportion of the labor force employed in manufacturing increased to 16.3 percent (1979), but declined during the crisis to 15.4 percent (1982).

As a consequence, public sector employment increased more rapidly than private sector employment. Between 1950 and 1980, while the latter grew at an average annual rate of 2.7 percent, the former rose at an average annual rate of 7.4 percent. Recently the difference has increased. Between 1973 and 1980 private sector employment grew, on the average, at an annual rate of 3.4 percent, while public sector employment increased more than twice as rapidly, at an average rate of 8.0 percent. This rapid growth of public sector employment, both in the central government and autonomous institutions, meant that the relative share of the public sector in total employment increased from 6.1 percent in 1950, to 15.3 percent in 1973, and to 19.7 percent in 1980. In the second half of the 1970s, about two out of every five new jobs in the economy were created by the public sector, such that today one out of every five workers is employed in this sector.

This explosion of public sector employment has reflected an implicit policy to keep unemployment low, particularly of qualified and professional workers, in the presence of trade and factor-price policies that have reduced the incentives to hire workers in the private sector. On the other hand, the rapid expansion of public sector employment has caused a growing fiscal deficit, which is at the root of the more recent financial crisis. In turn, the importance of wages in public expenditures has made it politically difficult to cut government spending. The concentration of workers in large public institutions has facilitated their unionization. Public-sector unions are the strongest in the country and have managed to maintain higher wages than those for similar occupations in the private sector, while at the same time preventing any reduction in the absolute size of government. Moreover, the competition for resources, particularly credit, has led to the crowding out of the private sector in the portfolio of the banking system and has contributed to the stagnation of the economy.

The fiscal constraint imposed by the recent crisis has resulted in a declining capacity of the public sector to absorb additional workers. Open unemployment increased from 4.1 percent of the labor force in 1950 to 7.3 percent in 1973, and to 9.4 percent in 1982. Economic stagnation and deterioration of the international terms-of-trade have made it impossible for the public sector to maintain a high rate of employment generation. Open unemployment has become a major political problem and has further complicated the process of adjustment.

EQUITY AND THE SIZE OF THE PUBLIC SECTOR

Another major element of Costa Rican development strategy, aside from industrialization and regional integration, has been the emphasis on equity and improvements in the quality of life. This emphasis has been reflected in the major public investment in education, health, nutrition, social welfare assistance to low-income families, social security, and various public-sector services. The concern for equity may be attributed to the nature of the political system. The democratic process has encouraged participation of all citizens in the selection of political leaders and open debate of economic and social issues. There has always been an active vocal opposition party to question government policy. This has been Costa Rica's unique heritage in the region, and successive governments of different political persuasion have preserved and enhanced social equity.

As measured by the performance of most social indicators and the development of a physical infrastructure for the benefit of all Costa Ricans, the results of the equity-oriented policies are outstanding. Progress in health care, for example, has dramatically reduced mortality rates. In Latin America, only in Argentina, Uruguay, or Cuba will a person born today have as high a life expectancy as one born in Costa Rica. In 1978 life expectancy was 73 years in the United States and 72 years in Costa Rica. Since life expectancy in Costa Rica was only 55 years in 1950, much progress was accomplished during the past three decades. Similarly, infant mortality in Costa Rica has experienced a remarkable reduction, from 75 per 1,000 births in 1958 to 19 per 1,000 births in 1980, and has rapidly approached the level of 15 per 1,000 births observed in the United States. Moreover, during the 1970s almost half of secondary-school age children were in school, and one-fifth of the university age cohort were attending an institution of higher education.[6]

The major beneficiaries of the growth experienced during the past decade and of many of these public-sector services have been the middle-income groups. Furthermore, the equity-oriented system has been very expensive, and a large bureaucracy has evolved to administer it. An increasing proportion of available resources has been devoted to paying public-sector employees, while the benefits reaching the respective target population have declined. Since the costs of these social programs have increased rapidly, exceeding the growth rate of public revenues, the government has been forced to borrow domestically and abroad. The political costs associated with any explicit reduction in these programs have been another major obstacle to policy adjustments.

In striving to attain ambitious social and economic development goals, successive governments have initiated numerous programs and built an elaborate array of public institutions to plan, administer, control, and conduct public- and private-sector activities. With large amounts of foreign assistance, Costa Rica built an impressive network of highways and feeder roads, an extensive electric power network, and a large telecommunications system. Although the positive impact of these investments has been great, the costs have also been high. Due to external financing, payment for this investment has been deferred to the future in ways that may continue to be a drain on the economy. Moreover, there has been considerable government intervention in the economy in terms of price controls, credit allocation, and subsidy schemes.[7]

The Costa Rican government has been not only a welfare state and an interventionist state, but an entrepreneurial state as well. Government ownership of several basic industries, including public transportation, oil refining and distribution, cement and fertilizer production, sugar refining, agricultural exports, insurance and, most importantly, banking has given the government considerable leverage with which to channel a large share of resources toward public-sector enterprises. A conspicuous example is CODESA, a public investment corporation that has accounted for an increasing share of total investment, even in manufacturing.

As a consequence of these policies, the public sector has become too large. Central government expenditures, which had represented 15.1 percent of the GDP in 1970, represented 21.8 percent by 1980. The protectionist strategy, which has relied heavily on tax exemptions and implicit subsidies, has resulted in an income-inelastic tax structure. In 1970 central government revenues represented 13.5 percent of the GDP, whereas by 1980 they represented only 12.7 percent. As a consequence of this behavior of expenditures and revenues, the central government deficit increased from 1.6 percent of the GDP in 1970 to 9.1 percent in 1980. If the rest of the public sector is added, the fiscal deficit represented 13.9 percent of the GDP by 1980. Moreover, by this time the public sector was contributing 25.2 percent of the GDP, 38.7 percent of investment, and 6.1 percent of savings, and was receiving 65.1 percent of the net increments in domestic credit. This size of the public sector is a substantial burden on a small, open economy. Adjustment to external shocks thus requires a reduction in the size of the public sector, a politically difficult proposition.

An important feature of the Costa Rican economy has been a high degree of government intervention in the financial sector. The four nationalized commercial banks have had a monopoly on demand and savings deposits and have accounted for over four-fifths of the assets of the financial system. These banks have been "characterized as slow, excessively conservative, and incapable of significantly contributing to the economic development of the country because of their implicit lending policies and their inability to mobilize internal savings."[8] Transaction costs have been high, bank services poor, and the credit rationing criteria arbitrary and vulnerable to political pressures. In the absence of competition, the banking system has been unresponsive to changing private-sector needs, steadily becoming obsolete, while a significant portion of its loan portfolio has been frozen due to default. Interest rate subsidies have resulted in substantial free transfers of resources to privileged borrowers, while credit portfolios have been highly concentrated in the hands of a few large borrowers.

During the crisis, as inflation accelerated, the flows of new loans, measured in real terms, sharply declined, affecting mostly productive activities. By 1982, the real size of the credit portfolio of the banking system was about 40 percent of its size a few years earlier. In addition, the share of the public sector in the domestic credit flows had increased substantially, whereas the private sector was crowded out. As a consequence, the system was not only mobilizing too few domestic savings; it was also contributing to their misallocation.

In summary, the structural problems associated with a conflict between the Costa Rican economy's most salient characteristics and the main features of the protectionist strategy of import substitution adopted have resulted in stagnation and rigidity. In addition, commodity-and-factor-price policies have resulted in increasing unemployment, while the expansion of the public sector and the unresponsiveness of the nationalized banking system have contributed to lack of growth and financial disequilibrium. All of these problems suggest the need for substantial discrete structural changes and policy adjustments, in order to reduce the degree and dispersion of protection, reduce the size of the public sector, and more effectively mobilize and allocate domestic savings through the banking system. Short-term instability and the perception that high political costs are associated with these reforms have not facilitated the decisions.

TERMS-OF-TRADE INSTABILITY

During the second half of the 1970s, Costa Rica experienced a comparatively large fluctuation in its international terms-of-trade. Although the information available for the 1950s is not completely reliable, it seems that during that period the country's terms-of-trade were more favorable than in the following two decades. For the 1950-59 period, the simple average of the annual composite index of export to import prices stood at 128.8 percent of its base value for 1966. From a historical high of 148.8 percent in 1954, however, this index had already declined to 101.1 percent by 1960. During the 1960s, on the other hand, these terms were extremely stable. The difference between the highest and lowest values, of 106.1 percent (1964) and 91.4 percent (1968), was only 14.7 points, whereas the difference had been 39.0 points during the 1950s. This stability continued until 1974, when the index dropped to a low of 76.5 percent of its 1966 base.

This sudden and significant worsening of the country's international terms-of-trade in 1974 was the consequence of the first oil crisis. It represented the first instance of an external shock resulting from a change in import prices, rather than a change in export volumes or prices. Given the stability of international prices prior to 1974, as well as Costa Rica's diversified import basket, changes in export prices, particularly those of coffee, cocoa, sugar, bananas, and beef had been the main determinants of changes in the country's terms-of-trade. After a period of almost complete stability, however, the index of import prices jumped by 37 percent in 1974. As a consequence of these changes and the expansionary credit policy that followed, the value of imports climbed from $455 to $720 million (a 58 percent increase in one year), while Costa Rica's trade deficit increased from $111 to $280 million, almost threefold. This was made possible by $13 million of surplus in the rest of the current account; $243 million of capital inflows (in comparison to $130 million the previous year); and a loss of $23 million in international monetary reserves.

This worsening of the country's international terms-of-trade was soon followed, however, by a rapid improvement and a significant growth in the value of exports, as a consequence of the coffee boom. By 1977, the terms-of-trade index had recovered to 114.7 percent--an implied increase of 38.2 points in three years. At the same time, the value of exports had climbed from $493 million in 1975 to $828 million in 1977, whereas the trade deficit had been reduced to $194 million. This deficit would have declined even more had it not been fueled by the expansion of domestic credit and foreign borrowing.

With the end of the coffee boom and the second oil crisis, Costa Rica's terms-of-trade deteriorated again in 1978. The index had dropped to 91.9 percent by 1980, a reduction of 22.8 points in three years. By 1982 the index had further dropped to 72.4 and to 69.5 in 1983. Since the level of the index at the end of the decade was not particularly low by historical standards, the crisis must be primarily associated with the violent fluctuation experienced in a short period of time.

This sharp fluctuation required a sharp adjustment. External shocks are not new to Costa Rica. In the past, however, unfavorable shocks had been followed by favorable ones. The impact of the first oil shock, for instance, was soon followed by the coffee boom. In recent years, however, all the external influences have been unfavorable, while domestic policy responses have been particularly unfortunate. Moreover, the economy has become less flexible, and the social and political costs of the required adjustments have increased.

POLICY RESPONSES

The oil crisis of 1974 imposed on Costa Rica an important adjustment problem. The deterioration of the country's terms-of-trade reduced real incomes and caused a contraction of the economy. The Figueres administration avoided the contraction by increasing the foreign debt and substantially expanding domestic credit. Domestic credit increased by 45.5 percent, leading to a loss of international monetary reserves and contributing to the country's first inflationary experience in half a century. The wholesale price index rose 26.4 percent in 1973 and 38.2 percent in 1974--this in a country where the simple average of the annual change in this index had been only 1.5 percent per annum during the previous twenty-two years. Thus, the main instruments of the Figueres administration to avoid the adjustment--foreign borrowing and domestic credit expansion--resulted in much higher inflation than that induced by international price changes. At the same time, Costa Rica's public external debt increased from $296 million in 1973 to $379 million in 1974 and $511 million in 1975.

In the following years, the large export earnings of the coffee boom made it possible to divert the inflationary pressures that resulted from the continued expansion of domestic credit toward the balance of payments, thus avoiding domestic price increases. By 1977 the annual rate of increase in the wholesale price index had declined to 7.4 percent. The coffee boom had validated, ex post, the gamble of the Figueres administration, and Costa Rica adjusted to the impact of the first oil crisis with relative success.

The extraordinary improvement of the country's terms-of-trade and the rapid expansion of export earnings associated with the coffee boom significantly increased real incomes. A good measure of the country's purchasing power is the gross national income (GNI)--that is, the gross national product corrected by the impact of changes in the terms-of-trade. In 1966 prices, the GNI increased by 12.5

percent in 1976 and by another 18.3 percent in 1977. This exceptional increase in real income made possible a substantial expansion of consumption, imports, and government spending. In 1966 prices, private consumption increased by 13.6 percent, public sector consumption by 8.8 percent, and imports by 25.1 percent during 1977 alone. In real terms, aggregate demand was 25.9 percent higher in 1977 than in 1975.

As a result of this expansion of aggregate demand, the economy became overheated. What was clearly an exceptional episode, in terms of the rate of improvement in real income, was rapidly accepted as the new norm. Coffee power had finally been achieved and this was celebrated with a spending euphoria. What was actually a transitory increase in income was viewed as a new higher level of permanent income, and aggregate spending was augmented accordingly. The Oduber administration made no effort to avoid this misperception. On the contrary, it actually stimulated the spending rush. No significant effort to mobilize domestic savings or increase taxation took place during the boom. Costa Rica continued to have one of the lowest ratios of domestic savings to the GDP in Latin America. Even at the peak of the boom, domestic savings represented only 12.7 percent of the GDP.

Moreover, given the attractive terms prevailing in the international capital markets, Costa Rica's foreign borrowing increased rapidly. The country's public external debt grew to $646 million in 1976 and to $834 million in 1977. By early 1978 the Oduber government was still borrowing abroad, at shorter terms and more restrictive conditions, merely to pile up international monetary reserves, which mounted to over $300 million by May 1978 when Carazo came to power. These loans had to be repaid during the following months. Oduber's mercantilist policy had exacted a heavy price on the country. In sum, government behavior led the public to believe that the new levels of spending could be maintained indefinitely. The international banking community added to this perception. Foreign lenders were actively encouraging the government to borrow and confirmed, with their behavior, the overly optimistic outlook of the future.

Thus, Costa Rica increased its level of aggregate spending not only in proportion to the exceptional revenues from the coffee boom but even beyond, aided by increasing inflows of foreign debt. By 1978, however, the country's terms-of-trade began to deteriorate again. With the same speed with which real purchasing power had increased during the coffee boom, it now declined. Between 1978 and 1981, the losses directly due to terms-of-trade changes increased eightfold, from 334 to 2,830 million colones. The latter loss was equivalent to one-third of the GDP. Also, the value of exports increased by only 4.4 percent in 1978 attempted to maintain at least their relative shares in the national income. The financial disequilibria were thereby increased, since the struggle of the social groups was facilitated by the government's expansionary credit policies. Domestic-credit expansion accentuated the balance-of-payments crisis, augmented the size of the fiscal deficit, and rapidly accelerated inflation. Between 1978 and 1980 Costa Rica's current account deficit increased from $363 to $664 million. This last deficit was financed by $192 million of capital inflows, a loss of $198 million of international monetary reserves and $274 million of interest arrears and other special loans in 1980. Another $100 million of reserves had already been lost during 1979. At the same time, the annual rate of increase of the wholesale price index had already risen to 24.1 percent in 1979, and reached 117.2 percent in 1981.

POSTPONING THE ADJUSTMENT

During the 1970s it became increasingly obvious that the strategy of import substitution was losing its dynamism. The early growth of manufacturing, during the easy stages of import replacement, was becoming more difficult to sustain, and Costa Rica's inability to compete in international markets became clear. The protectionist strategy, by favoring import-competing activities in the manufacturing sector, had reduced the relative profitability of exports. Toward the end of the decade, exports were also being heavily penalized by an exchange rate that overvalued the domestic currency. These policies, in the presence of inflationary pressures, led to a gradual stagnation of export volumes.

The slow growth of exports, in turn, severely limited the expansion of domestic manufactures, so dependent on imported inputs. The dynamic opportunities offered by the protectionist strategy were also disappearing in the other Central American countries. Insurgencies and political turmoil further contributed to the breakdown of the Common Market. At the same time, it became obvious that the fiscal deficit that resulted from the accelerated expansion of the public sector was becoming unmanageable. Many people discussed the need for a structural adjustment, including a sharp revision of the protectionist strategy, a reduction in the size of the public sector, and a financial reform. Manufacturers, organized as a powerful Chamber of Industries, bitterly argued against any reform. The government claimed that the social costs of the adjustment were too high and accordingly postponed it. It was believed that any abandonment of the protectionist strategy would lead to widespread bankruptcies and that any reduction in the size of the public sector would bring high unemployment. The unfavorable short-term circumstances, due to the external shocks, further added to the perceived social and political costs of the adjustment.

Toward the end of the decade the current account deficit was almost nine times greater than at the beginning, while capital inflows were becoming less and less capable of financing these deficits. Economic and political instability in Central America negatively impacted expectations. Both local and foreign investors rapidly lost confidence in the future of the region. New foreign investment disappeared, whereas repatriation of previous investment accelerated. At the same time, Costa Ricans increased their investments abroad and substantial capital flight took place. As a consequence, the country was faced with a balance-of-payments deficit in both the current and the capital accounts and rapidly lost international monetary reserves. A balance-of-payments adjustment was necessary.

The Carazo administration reacted to the external shock associated with the decline in primary commodity prices and the second oil crisis by further increasing foreign borrowing and expanding domestic credit. Growing inflationary pressures and pessimistic expectations induced portfolio revisions. Costa Ricans started to replace their assets denominated in _colones_ (particularly cash balances and other financial assets) with assets denominated in foreign currencies, further accentuating the capital outflow. Unwilling to facilitate an appropriate adjustment, Carazo refused to devalue the _colon_, even after the country's net international monetary reserves became negative. A huge political cost was supposedly associated with a devaluation, and the president himself increased this cost by arguing that a devaluation would be the worst possible evil and by repeatedly insisting that he would not devalue. The rate of exchange was kept at 8.54 colones per dollar until September 1980, and when it was eventually freed, it rapidly increased to 38 colones by the end of 1981 and 65 colones by mid-1982. The adjustment had been postponed but not avoided.

Carazo's refusal to devalue is a clear example of fear of the consequences of adjusting and of the resulting policy-making paralysis. It was evident that the overvalued exchange rate was responsible for the decline in export volumes and was subsidizing capital flight. Most Costa Ricans were firmly convinced that a devaluation was inevitable, so it was riskless to speculate against the colon. The extraordinary increase in foreign borrowing, was thus financing this speculation, further augmenting the demand for foreign currencies as well as the gap between the official and the equilibrium exchange rates. The consequences of this policy were both predictable and disastrous.

Carazo's unwillingness to devalue made it necessary to increase the public external debt beyond any reasonable magnitude. The future growth of the Costa Rican economy was compromised by the heavy burden of servicing this debt. The speculative demand for foreign currencies, which was promoted by the failure to devalue, increased the equilibrium level of the exchange rate far beyond what was necessary, thereby augmenting the magnitude of the price adjustment required. The substantial speculative movements that were thus subsidized resulted in massive redistributions of income, aggravating the sociopolitical situation. The delay in adjusting greatly increased adjustment costs. Structural changes, beyond devaluation, became even more difficult to pursue.

IMPOVERISHMENT: THE SOCIAL COSTS OF POLICY PARALYSIS

Costa Ricans will be much poorer in the 1980s than they were in the 1970s. A much lower rate of growth of output, particularly if structural adjustments do not occur, combined with a high rate of population growth will lead to a decline of per capita income during the first half of the decade and to a slow recovery during the second half. It has been estimated that even under ideal circumstances the 1979 level of per capita income will not be realized again before 1990. This would require an average real rate of growth of GDP of 5.3 percent per annum between 1984 and 1990--albeit a difficult target to achieve. Moreover, the continued deterioration of the country's international terms-of-trade means that the same GDP generates less purchasing power over foreign goods than before--this in a country where such goods have represented up to 50 percent of the aggregate supply. Finally, a much larger proportion of the GDP will have to be devoted to servicing the country's external debt, instead of to domestic consumption and investment. Servicing this debt may require over 50 percent of the value of exports and about 15 percent of the GDP each year.

Costa Ricans will be paying in the future for the excess consumption of the late 1970s. Moreover, not only will debt service significantly reduce disposable income, but the foreign exchange requirement of this service will impose a drastic constraint on imports. In the absence of policy changes leading to an adjustment of the structure of production to the new circumstances, a reduction of imports of raw materials, intermediate inputs, and capital goods will impose a severe limitation on the growth rate of the manufacturing sector and, to a smaller extent, the agricultural sector. This brake on growth, in turn, may eventually reduce the country's ability to service the external debt, thus possibly leading to a continuous and increasingly onerous rescheduling of the debt and even to formal bankruptcy.

POLITICAL COSTS

Costa Rica is currently experiencing the most serious crisis on its recent history--a truly major crisis given its depth, duration, and potential consequences for the country's sociopolitical and institutional framework. This framework has itself increased the difficulties of adopting the policies required to pull out of the crisis and minimize its consequences. Very high social costs, higher than any the country has had to face before, will be paid before the adjustment is over. These costs are so great that they pose a difficult test for institutional stability and political equilibrium. Further delay of policy decisions to facilitate the appropriate adjustment, although politically attractive in the short run, would pose a major threat to the system itself.

Costa Rica is an open society, with a long democratic tradition and a high degree of political participation. Numerous interest groups contribute to the decisionmaking process. The free press has been an important forum through which competing groups register their opinions and exercise their influence. The need for a consensus, however, delays major policy decisions. Measures have not been adopted with the speed, opportunity, and strength required. The same features that make the political system so attractive also make it vulnerable and fragile.

The crisis has increased the vulnerability of the political system due to the high expectations of Costa Ricans, already accustomed to a continued improvement in their standard of living. These expectations were reinforced by the high growth rates of the 1970s and confirmed by the coffee boom. During the 1980s, however, the Costa Rican economy will not be in a position to satisfy the demands generated by these expectations. The declining dynamism of the economy will make it impossible not only to guarantee a continued improvement of living standards, but even to avoid impoverishment.

Moreover, Costa Ricans have become accustomed to an institutional system that provides a large quantity of public goods: free education from primary school through university, free health care, and good nutrition for everyone. Cheap water and electricity have been introduced in most homes. Substantial income tranfers have been channeled by the public sector, which in turn has provided many employment opportunities. Not only will the economy be unable to continue financing these services and transfers, but the size of the public sector itself will inevitably shrink. Many public goods, taken for granted, will no longer be freely provided. At the same time, economic stagnation and inflation will further worsen income distribution. The burden of impoverishment will be shared more than proportionately by the already poor. This deterioration of standards of living will be faced by a generation that has not known adversity before. The resulting frustration may lead to social unrest and violence, so conspicuously absent from Costa Rican history.

Many have claimed that the political costs of adjusting are too high and so justify their unwillingness to modify economic policies. I conclude that, if the long-term deterioration of the political system is to be avoided, Costa Rica requires a series of sharp, rapid adjustments induced by bold economic policy revisions, including a much lower and uniform rate of protection of import substitution manufacturing, a reduction in the level of implicit or explicit subsidies, a much smaller public sector, particularly in productive areas, and a drastic overhauling of the financial sector, in order to increase the share of domestic savings in financing investment. The Costa Rican democracy may not be able to survive the kind of prolonged crisis that would result from the continued postponement of this adjustment, particularly in view of the regional turmoil. Changes must be undertaken before expectations become even more pessimistic and before violence and confrontation upset the country's political fabric. Drastic policy changes may actually be the signal, for Costa Ricans and for foreigners, that the country possesses the will and discipline needed to overcome its crisis.

NOTES

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1. Robert Pratt et al., Private Sector: Costa Rica. A.I.D. Evaluation Special Study No. 9 (Washington, D.C.: Agency For International Development, March 1983), p. vi.

2. Given the disequilibrium of the foreign exchange market, it is difficult to select an exchange rate to convert colones into U.S. dollars. Under the author's assumption that the equilibrium rate was close to 40 colones per dollar, this figure was equivalent to $2.5 billion.

3. The text of this chapter includes the values of numerous economic variables. Some of these values are either reported in the following Statistical Annex or have been computed from figures in that annex. The remaining

data have been obtained from official sources, mostly Central Bank publications, and have been reported also in the following books: Claudio González-Vega and Víctor Hugo Céspedes, Growth and Equity: Changes in Income Distribution in Costa Rica (New York: United Nations, 1984); V. H. Céspedes, Claudio González-Vega, Ronulfo Jiménez, and Thelmo Vargas, Costa Rica: Problemas Económicos para la Década de los 80s (San José: Editorial Studium, 1983); Víctor Hugo Céspedes, Claudio González-Vega, Ronulfo Jiménez, and Eduardo Lizano, Costa Rica: Una Economía en Crisis (San José: Editorial Studium, 1983); Víctor Hugo Céspedes, Ronulfo Jiménez, and Eduardo Lizano, Hacia el Empobrecimiento del País: Costa Rica en 1982 (San José: Academia de Centro América, 1983); and in COUNSEL, Repertorio Económico (several years).

4. Effective rates of protection indicate the extent to which domestic value added can exceed value added at competitive international prices; they also take into account both nominal tariff rates on the product and its imported inputs.

5. Alan I. Rapoport, "Effective Protection Rates in Central America," in Economic Integration in Central America, eds. William R. Cline and Enrique Delgado (Washington, D.C.: Brookings Institution, 1978).

6. González-Vega and Céspedes, Growth and Equity.

7. See Pratt et al., Private Sector, p. ix, for details on several of these issues.

8. Ibid., p. 21.

STATISTICAL ANNEX

Table 1. Costa Rica: Average Annual Rates of Growth, in Real Terms, of Selected Production Indicators, 1960-82 (Percentages).

Year	GDP	GNP	GNI	GDP Agri-cult.	GDP Manu-fact.	GDP Cons-truct.	GDP Com-merce
1960-65	5.1	n.a.	n.a.	3.2	9.2	5.8	5.0
1965-70	7.0	7.0[a]	6.4[a]	8.1	9.3	4.3	6.7
1970-75	6.0	5.8	3.4	3.4	8.9	10.9	3.0
1975-80	5.2	4.7	5.8	1.8	6.0	9.4	6.2
1974	5.5	6.4	- 1.5	-1.7	12.7	7.8	- 0.7
1975	2.1	1.1	3.8	3.0	3.2	5.7	- 4.2
1976	5.5	5.1	12.5	0.5	5.8	20.8	8.9
1977	8.9	9.2	18.3	2.2	12.7	3.9	17.9
1978	6.3	5.5	0.2	6.6	8.2	5.8	4.2
1979	4.9	4.3	- 0.3	0.5	2.7	19.3	4.1
1980	0.8	-0.4	- 0.4	-0.5	0.8	- 1.1	3.0
1981	-2.3	-4.0	-28.9	5.1	-0.5	-21.7	-10.6
1982	-9.1	-10.1	-60.2	-4.9	-14.9	-32.6	-16.8
1983[b]	0.8	n.a.	n.a.	4.4	-1.8	-6.0	-1.0

Notes: Rates of growth have been computed on the basis of values in constant 1966 prices.
GDP: Gross Domestic Product.
GNP: Gross National Product.
GNI: Gross National Income, as defined in this chapter.
[a] For 1966-70.
[b] Preliminary estimates.

Sources: Banco Central de Costa Rica, <u>Cuentas Nacionales de Costa Rica</u> (several years); Víctor Hugo Céspedes, Claudio González-Vega et al., <u>Problemas Económicos en la Década de los 80</u> (San José: Editorial Studium, 1983); Víctor Hugo Céspedes, Claudio González-Vega et al., <u>Costa Rica: Una Economía en Crisis</u> (San José: Editorial Studium, 1983); COUNSEL, Repertorio Económico (several months).

Table 2: Costa Rica: Average Annual Rates of Growth, in Real Terms, of Selected Macroeconomic Variables, 1960-82 (percentages).

Year	Per Capita GDP	Per Capita Consump.	Private Consump.	Gov't Consump.	Gross Fixed Invest.	Fixed Invest. & Invent.	Exports	Imports
1960-65	1.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1965-70	4.4	3.3[a]	6.4[a]	5.3[a]	10.0[a]	8.4[a]	0.5[a]	13.6[a]
1970-75	2.7	0.8	3.2	5.4	4.2	6.2	7.4	3.1
1975-80	2.5	2.5	5.2	5.8	9.4	12.6	4.4	9.2
1974	3.4	n.a.	5.2	8.4	9.7	8.6	7.3	9.4
1975	- 1.1	n.a.	2.2	5.7	- 1.2	- 8.9	- 2.0	- 7.3
1976	6.1	n.a.	4.2	7.8	23.7	26.5	5.4	16.2
1977	3.5	10.7	13.6	8.8	12.4	22.8	8.2	25.1
1978	2.2	5.6	8.4	3.7	8.1	- 0.4	9.9	7.5
1979	- 2.0	- 0.3	2.4	7.7	15.3	9.3	3.3	2.9
1980	- 7.1	- 4.5	- 1.8	1.5	- 9.4	7.0	- 4.3	- 3.4
1981	- 5.1	-11.3	- 8.5	-5.6	-24.9	-37.7	11.1	-26.3
1982	-11.9	-12.6	- 9.8	-2.8	-38.7	-48.1	-10.1	-32.0
1983[b]	- 2.0	- 1.5	1.3	2.7	- 7.3	5.8	0.0	4.3

Notes: Rates of growth have been computed on the basis of values in constant 1966 colones.
[a] For 1966-70.
[b] Preliminary estimates.

Sources: The same as in Table 1.

Table 3. Costa Rica: Proportions of Gross Domestic Product for Selected Sectors of Economic Activity, 1950-82 (percentages).

Year	Agri cult.	Manu-fact.	Central Gov't.	Other	Exports	Imports
			Nominal Terms			
1955	38.3	13.3	7.7	40.7	25.0	26.0
1960	26.0	14.2	9.0	50.8	21.4	26.2
1965	23.5	26.8	9.7	50.0	22.8	33.3
1970	22.5	18.3	10.6	48.6	28.2	35.0
1974	19.4	20.3	11.9	48.4	33.5	48.3
1975	20.3	20.4	12.4	46.9	30.4	38.7
1976	20.4	19.7	13.0	46.9	29.4	35.3
1977	21.9	99.0	12.9	46.2	31.1	36.5
1978	20.4	18.8	14.0	46.8	28.4	36.2
1979	18.5	18.3	15.0	48.2	26.9	37.3
1980	17.8	18.6	15.2	48.4	26.5	36.8
1981	23.0	18.9	13.4	44.7	43.3	48.2
1982	24.7	20.3	11.7	43.3	43.3	39.2
1983[a]	23.3	19.9	13.1	43.7	34.5	35.4
			Real terms[a]			
1957	24.4	14.1	12.1	49.4	n.a.	n.a.
1960	25.2	13.8	11.3	49.7	n.a.	n.a.
1965	22.9	16.7	10.8	49.6	25.0	30.9
1970	24.1	18.6	9.9	47.4	34.2	39.6
1974	21.0	21.0	10.2	47.8	37.9	37.9
1975	21.2	21.2	10.3	47.3	36.4	34.4
1976	20.2	21.3	10.1	48.4	36.4	37.8
1977	19.0	22.0	9.8	49.2	36.1	43.5
1978	19.0	22.4	9.7	48.9	37.4	44.0
1979	18.2	22.0	9.7	50.1	36.8	43.1
1980	18.0	22.0	10.0	50.0	34.9	41.3
1981	19.3	22.4	10.4	47.9	39.7	31.1
1982	20.2	20.9	11.2	47.7	39.2	23.3
1983[b]	21.0	20.4	11.1	47.5	38.9	24.1

[a] In 1966 prices.
[b] Preliminary estimates

Sources: The same as in Table 1.

Table 4. Costa Rica: Selected Indicators of Population, Employment and Unemployment, 1950-82.

Year	Total Population ('000)	Annual Rates of Growth: Population	Employment: Total	Employment: Private	Employment: Public	Proportion of Labor Force: Unemployment	Proportion of Labor Force: Un- and Under-Employment
1950	858	3.3	n.a.	n.a.	n.a.	4.1	n.a.
1963	1,380	3.7	2.5[a]	1.9[a]	8.8[a]	6.9	n.a.
1973	1,872	3.1	3.6[a]	3.4[a]	5.1[a]	7.3	n.a.
1976	2,018	2.5	4.4[a]	3.8[a]	7.7[a]	6.3	9.0
1977	2,071	2.6	6.4	5.4	11.5	4.6	7.5
1978	2,126	2.7	5.6	4.2	12.1	4.6	7.6
1979	2,184	2.7	3.3	3.6	2.2	4.9	9.6
1980	2,245	2.8	0.9	- 0.6	7.4	5.9	10.5
1981	2,306	2.7	0.5	0.7	0.1	8.7	14.6
1982	2,370	2.7	4.6	7.0	- 5.3	9.4	16.4
1983[b]	2,434	2.7	1.0	- 0.5	8.0	9.0	n.a.

Notes: Open unemployment: those members of the working force who are looking for a job and can not find one.
Visible underemployment: those members of the working force who can find only a part-time job. (Equivalent rate).
[a] Annual averages for the 1950-63, 1963-73, and 1973-76 periods.
[b] Preliminary estimates.

Sources: Dirección General de Estadística y Censos, Censos de Población (1950, 1963, and 1973); Ministerio de Trabajo y Seguridad Social, Encuesta Nacional de Hogares, Empleo y Desempleo (several years); Víctor Hugo Céspedes and Claudio González-Vega, Growth and Equity. Changes in Income Distribution in Costa Rica (New York: United Nations, 1983).

Table 5. Costa Rica: Proportions of the Labor Force Employed in Different Sectors, 1950-82 (percentages).

Year	Agricult.	Manufact.	Construct.	Other	Private	Public	Urban[a]	Rural[a]
1950	54.7	11.3	4.3	29.7	93.9	6.1	36.2	63.8
1963	49.7	11.7	5.5	33.1	86.7	13.3	37.0	63.0
1973	38.2	12.9	6.9	42.0	84.7	15.3	43.4	56.6
1976	34.8	14.6	6.5	44.1	83.2	16.8	46.1	53.9
1977	33.0	15.8	6.4	44.8	82.4	17.6	47.0	53.0
1978	30.3	15.2	7.4	47.1	81.3	18.7	47.5	52.5
1979	28.7	16.3	7.7	47.3	81.5	18.5	47.8	52.2
1980	27.4	16.3	7.8	48.5	80.3	19.7	48.3	51.7
1981	27.8	15.6	6.8	49.8	80.4	19.6	48.8	51.2
1982	30.2	15.4	5.7	48.7	82.3	17.7	48.4	51.6
1983[b]	28.3	16.4	5.2	50.1	81.0	19.0	49.6	50.4

[a] Proportions of the total labor force.
[b] Preliminary estimates.

Sources: The same as in Table 4.

Table 6. Costa Rica: Indexes of Import and Export Prices, International Terms-of-Trade, and Real Wages, 1950-82.

Year	Index: Export Prices	Index: Import Prices	Index: Terms Trade	Annual Rates of Change: Export Prices	Annual Rates of Change: Import Prices	Annual Rates of Change: Terms Trade	Annual Rates of Change: Real Wages
1950	98.4	78.8	124.9	n.a.	n.a.	n.a.	n.a.
1955	124.2	104.1	119.3	4.8[a]	5.7[a]	- 0.9[a]	n.a.
1960	96.2	95.1	101.1	- 5.0	- 1.8	- 3.3	n.a.
1965	100.5	99.3	101.3	0.9	0.9	0.0	n.a.
1970	86.7	99.4	87.2	- 2.9	0.0	- 3.0	n.a.
1975	145.2	182.7	79.4	10.9	12.9	- 1.9	n.a.
1980	231.6	252.0	91.9	9.8	6.6	3.0	n.a.
1974	127.7	167.1	76.5	19.9	37.1	-12.5	- 4.4
1975	145.2	182.7	79.4	13.7	9.3	3.8	- 2.6
1976	164.2	173.7	94.5	13.1	- 4.9	19.0	5.6
1977	209.8	182.9	114.7	27.8	5.3	21.4	6.4
1978	195.8	193.7	101.1	- 6.7	5.9	-11.9	7.2
1979	205.2	222.1	92.4	4.8	14.7	- 8.6	6.0
1980	231.6	252.0	91.9	12.9	13.5	- 0.5	- 3.9
1981	211.9	269.2	78.7	- 8.5	6.8	-14.4	- 6.2
1982	210.4	290.8	72.4	- 0.7	8.0	- 8.0	-29.0
1983[b]	214.2	308.2	69.5	1.8	6.0	- 4.0	n.a.

Notes: Index of export and import prices in U.S. dollars.
Terms-of-trade are the ratio of export to import prices.
[a] Average annual rates of change for the periods 1950-55, 1955-60, etc.
Rates of change of a real wage index (base year: 1973), when wages are deflated by the consumer price index.

[b] Preliminary estimates.

Sources: Banco Central de Costa Rica, _Balanza de Pagos_ (several years); Claudio González-Vega and Víctor Hugo Céspedes, _Growth and Equity. Changes in Income Distribution in Costa Rica_ (New York: United Nations, 1983). See also sources for Table 4 and for Table 1.

Table 7. Costa Rica: Annual Rates of Price Changes, Interest Rates, and Exchange Rates, 1950-82.

Year	Annual Rates of Change: GDP Deflator	Agricult. Deflator	Manufact. Deflator	WPI	CPI	Exchange Rate	Real Interest Rate
1950-55	n.a.	n.a.	n.a.	- 1.4	2.0	6.63[a]	n.a.[a]
1955-60	- 0.4[b]	- 6.2[b]	1.9[b]	0.4	1.5	6.63	n.a.
1960-65	1.4	3.3	1.0	0.3	1.3	6.63	6.3
1965-70	3.4	1.5	3.0	4.8	3.1	6.63	- 3.3
1970-75	13.9	14.5	13.4	17.4	14.7	8.54	- 2.0
1975-80	13.8	14.5	11.0	13.3	9.7	14.40	- 3.3
1974	23.2	27.0	19.1	38.2	n.a.	8.54	-20.1
1975	24.5	29.3	21.0	14.0	20.5	8.54	- 2.0
1976	16.6	22.7	12.3	7.2	4.4	8.54	4.9
1977	16.9	33.8	8.9	7.4	5.3	8.54	4.5
1978	7.9	0.3	4.6	9.4	8.1	8.54	2.5
1979	9.1	3.3	9.0	24.1	13.2	8.54	- 9.2
1980	18.8	15.8	20.7	19.3	17.8	14.40	- 3.3
1981	44.6	69.7	41.2	117.2	65.1	37.80	-45.2
1982[c]	93.5	91.6	113.4	79.1	81.8	45.20	-32.2

Notes: WPI: Wholesale price index. Base year: 1966.
CPI: Consumer price index. Base year: 1975.
Exchange rate: colones per U.S. dollar, at the end of the year.
Real interest rate on colones term deposits, with respect to WPI.
[a] At the end of the five-year periods.
[b] For 1957-1960.
[c] Preliminary estimates.

Sources: Banco Central de Costa Rica. *Cuentas Nacionales* and *Boletín Estadístico* (several years). Direccion General de Estadistica y Censos. *Indice de Precios al Consumidor de Ingresos Medios y Bajos del Area Metropolitana de San Jose* (several years). COUNSEL, *Repertorio Economico* (several years).

Table 8. Costa Rica: Balance of Payments and Public External Debt. (Millions U.S. dollars). 1950-1982.

Year	Exp.	Imp.	Trade Balance	Current Account[a]	Priv. Cap.	Offic. Cap.	Capital Account	Change Net Reserves	Public External Debt
1950	54	46	8	1	n.a.	n.a.	- 2	- 1	29
1955	81	87	- 6	- 7	n.a.	n.a.	11	4	23
1960	84	110	- 26	- 19	n.a.	n.a.	16	- 3	28
1965	112	178	- 66	- 67	n.a.	n.a.	69	2	148
1970	231	317	- 86	- 74	n.a.	n.a.	58	- 16	164
1974	440	720	-280	-266	168	75	243	- 23	379
1975	493	694	-201	-218	106	133	239	21	511
1976	593	770	-178	-201	137	129	266	65	646
1977	828	1,022	-194	-226	156	178	334	109	834
1978	865	1,166	-301	-363	103	233	336	- 27	1,044
1979	934	1,397	-462	-558	57	400[c]	457	-100	1,398
1980	1,002	1,524	-522	-664	63[d]	403[c]	466	-198	1,735
1981	860	1,209	-200	-409	- 48[d]	411[c]	362	- 47	2,743
1982[b]	1,008	867	-7	-209	49[d]	298[c]	347	138	3,438
1983[b]	803	930	-127	-373	100[d]	178[c]	278	- 95	n.a.

[a] Includes overdue interest on public sector loans, not paid and which amounted to $178.3 (1980), $292.5 (1981), $316.5 (1982), and $412.6 (1983).

[b] Preliminary estimates.

[c] Includes IMF loans and other balance-of-payments assistance.

[d] Includes errors and omissions.

Sources: Banco Central de Costa Rica, Balanza de Pagos (several years); COUNSEL, Repertorio Económico (several months).

Table 9. Costa Rica: Selected Fiscal, Credit and Monetary Indicators, 1950-1982.

	Ratios with Respect to GDP						Ratio	Proport.
	Central Gov't			Public	Money		Dom.	Public
Year	Expend.	Reven.	Deficit	Sector Deficit	Supply M2	Domestic Savings	Savings/ Net inv.	Sector Credit
1950	n.a.	n.a.	n.a.	n.a.	n.a.	7.9	n.a.	23.1
1955	n.a.	n.a.	n.a.	n.a.	20.5[a]	3.8	n.a.	5.9
1960	n.a.	n.a.	n.a.	n.a.	22.2	7.5	60.7	12.7
1965	16.1[b]	12.1[b]	4.0[b]	n.a.	22.9	2.2	15.6	14.5
1970	15.1	13.5	1.6	n.a.	24.4	6.9	45.2	19.1
1974	17.6	14.6	3.0	n.a.	3.05	5.1	22.2	19.6
1975	17.5	13.5	4.0	n.a.	33.0	5.7	32.0	20.5
1976	19.2	13.0	6.2	n.a.	35.8	10.7	54.2	23.0
1977	17.7	13.2	4.4	n.a.	36.8	12.7	61.1	26.6
1978	19.6	13.6	6.0	9.0	41.6	8.6	43.4	28.7
1979	20.6	12.6	8.0	11.9	57.3	6.9	31.6	38.0
1980	21.8	12.7	9.1	13.9	42.4	7.1	30.2	44.3
1981	16.6	12.5	4.1	14.0	54.9	11.7	42.7	46.7
1982	16.6	13.2	3.4	9.9	46.6	n.a.	n.a.	n.a.
1983[c]	19.7	16.5	3.2	n.a.	n.a.	n.a.	n a	n a.

Notes: All ratios of fiscal magnitudes are computed with respect to Gross Domestic Product, except that of Domestic Savings, which is given with respect to National Disposable Income. The proportion of public-sector credit includes the share of domestic credit for the central government and for the rest of the public sector.

[a] For 1957.
[b] For 1966.
[c] Preliminary estimates.

Sources: Banco Central de Costa Rica, Memoria Anual and Crédito y Cuentas Monetarias (several years). The same as in Table 1.

while, as a consequence of the second oil crisis, the value of imports increased by 14.2 percent. The trade deficit jumped to $301 million, and a new adjustment was required.

The time had arrived for consumption, imports, and government spending to return to their historical levels. Political opposition to the contraction, however, was fierce. The spending orgy had created all kinds of expectations, and no one wanted to rectify the earlier mistakes. The Carazo administration did not help matters. Based on a weak coalition, it could not control the efforts of various pressure groups to avoid the direct impact of the adjustment. Carazo himself wanted to be remembered for his efforts to expand the country's physical infrastructure and for his role in the overthrow of the Somoza regime. Both targets were expensive. He chose, therefore, to postpone the adjustment. Again, the main tool for this postponement was borrowing in the international capital markets. The country's public external debt increased to $1,735 million by 1980, in per capita terms the highest in the Third World. In late 1982 this debt represented over one and a half years of Costa Rica's GDP and amounted to about $1,500 per capita. The country's private external debt represented about $1,000 million more.

All social groups struggled to maintain the standard of living achieved during the coffee boom. As it became obvious that impoverishment was inevitable, these groups